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OGC Has Reviewed

REPORT OF AUDIT

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28 June 1949

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TO : [REDACTED]

THRU : Chief, Confidential Funds Branch

SUBJECT: Report of Audit - [REDACTED]

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[REDACTED]

2. PURPOSE AND SCOPE OF REVIEW - The audit was conducted for the purpose of verifying the costs billed to the Agency by the Contractor. The contract was let on a "cost-plus-a-fixed-fee" basis and terminated, after several extensions of both termination date and cost limitation, on 1 February 1949. The review, therefore, covered only the period from 2 June 1947 through 31 January 1949 although the Contractor maintains it has incurred additional costs after 31 January 1949 which, admittedly, cannot now be claimed.

3. CONTRACT COSTS AND THEIR VERIFICATION - There is attached EXHIBIT I reflecting allowable contract costs and constituting a recommended settlement for this contract. This statement does not give effect to the unknown amount of allowance for purchases of materials by the Contractor which matter will be discussed later herein.

a. SALARIES AND WAGES

\$71,376.06

This amount includes the salaries and wages of both officers and employees of the Contractor who have been engaged directly in performance under the contract. In addition, it includes an item of \$21,952.28, representing the known charges for labor applied to the work in progress by the [REDACTED] a firm associated with the Contractor through identity of the head of each organization and in physical proximity. Although these [REDACTED] charges had been classified by the Contractor as materials and services, the writer believes they are more properly presented as Direct Labor. There has been disallowed the sum of \$66.24 in charges determined to be applicable to another job or account. In certain few instances, it was not possible to locate time cards reflecting an application of time to the job as billed by the Contractor, but these charges have been allowed where the time in secondary records has been treated as a charge to the job. These charges occurred in the early months of the contractual period.

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Except for the [redacted] labor, salaries and wages were verified by reference to time cards and an inspection of all canceled pay roll checks.

b. MATERIALS AND SERVICES

\$18,677.69

There has been disallowed a total of \$28.94 in California sales tax, cash discount in excess of 1% taken but not passed on to the Agency and duplicate billings.

In verification, these charges were traced to the original invoices and to the canceled checks in payment thereof.

c. OVERHEAD

\$25,945.46

Overhead which was distributed to the Contractor's jobs on the basis of percentage of direct labor cost, bears a ratio of 52.50% to the allowable salaries and wages which amounts to \$49,423.78 before the addition of the [redacted] labor. It will be observed that the contract, being of a style which in this respect is no longer employed by the Agency provides in Article 2.(e)(3) that the Contractor may bill "An allowance for overhead costs not otherwise reimbursable hereunder in an amount equal to one hundred percent (100%) of the total salaries and wages (but not taxes) reimbursable under subparagraph (1) hereof." (underscoring supplied). Through the Contractor's election to charge only such overhead as was actually incurred, and on the assumption that the completion of the work was desired, it would appear the Agency has been afforded a saving of \$23,478.32. This sum represents the difference between allowable Direct Labor of \$49,423.78 and Overhead of \$25,945.46. Consistent, however, with the Contractor's election to bill only actual allowable overhead, there has been disallowed as a result of the audit, the sum of \$1,671.37 consisting largely of Sales, Travel, Entertainment and Advertising Expenses which either are disallowable in principle or were determined to be inapplicable to the subject contract. The balance of disallowance consists of certain net overcharges resulting from errors in computation.

In confirmation, the expense ledger totals which were accepted without verification, were recapitulated and the allowable Direct Labor for each month compared with Total Direct Labor to establish the basis of proportion. The resulting percentage was applied to overhead expenses to determine the appropriate charge. Significant expense accounts were then analyzed, some in detail and others only selectively, and entries traced to original vouchers which were themselves scanned. Sufficient satisfaction as to the incurrence of such expenses and the distribution thereof was thereby obtained without a detailed audit of all overhead accounts.

d. COMMUNICATIONS

\$134.00

This item covers charges for long distance telephone calls and telegrams. These items were only test checked rather than checked in detail in view of the relative insignificance of the individual charges.

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25X1A

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25X1A e. TRAVEL \$550.56

This item consists principally of one trip from [REDACTED] California to Washington, D. C. and return, accomplished by [REDACTED] at a cost of \$408.12 and a trip from [REDACTED] California and return for [REDACTED] costing \$68.41. In addition there are included charges for numerous auto trips within the immediate area of Sierra Madre which have been reimbursed at a rate of 5¢ per mile as allowed by Article 2.(e)(5) of the contract.

25X1A

The charges on [REDACTED] trip to Washington were verified, but other items were tested only selectively rather than verified in detail.

f. JANUARY 1949 CHARGES NOT YET BILLED

It will be observed that the attached exhibit reflects January 1949 costs of \$1,468.77 and the balance of the Fixed Fee of \$146.82 on total allowable costs of \$116,683.79, neither of which have been billed to or paid by the Agency. That these items have not yet been billed is due to the fact that the bill for January 1949 included only such charges as would bring the total cumulative billing up to the contract limitation of \$125,000.00. Naturally, through disallowances totalling \$1,890.20 disclosed in the audit, there results an unexpended balance in an equivalent amount. The Contractor, fully aware of the loss he has incurred through an inability to bill these costs and fee due to time and cost restrictions, has indicated his determination to submit a supplemental bill for January costs not yet billed as soon as he is informed of the extent of the disallowances.

In view of these considerations, the writer recommends that these costs and fee totaling \$1,615.59 be allowed provided the Contractor submits its bill in substantiation.

4. SURPLUS MATERIALS - It is understood there are two matters in connection with property accounting which remain unfinished at this time. The Contractor must submit to the Agency an accounting for property furnished by the Government and for property purchased by the Contractor and charged to the Government under this contract. Article 3. of the contract affords the Contractor the right to retain upon termination of the work that property which was purchased under the contract by returning such amount as the Agency determines to be a fair price for the articles desired by the Contractor. The exercise of this right is subject to a determination by the Contracting Officer of the advisability of such an action. In pursuance of this article, the Contractor proposes to submit a list of the property such as test equipment which it wishes to purchase, and has already agreed to allow the Agency the full original cost of such property. In view of the fact that this property has presumably already depreciated to some extent through its use in the project, this proposal seems eminently fair.

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The second matter involves property of a less permanent or expendable character the value of which, the writer understands, has appreciably diminished through use in connection with the subject work. The Contractor proposes to submit a bid for these materials which, of course, may be compared with other bids which the Contracting Officer may wish to obtain. The writer made no effort to review the Contractor's proposals in this connection, as he was neither qualified nor authorized to evaluate their reasonableness. He did, however, request that the equipment and materials to be purchased or bid in be identified insofar as practicable with the invoices reflecting the original purchase so that original cost might be independently determined from invoices on file in this branch.

5. UNRECOVERED COSTS - The acceptance of the Contractor's proposals in these matters of accounting for property purchased under the contract would result in reduction of the net contract cost to the Government. The question would then arise as to whether the Contractor might be permitted to recover—to the extent of the agreed price for these materials—certain other costs recorded in February and March 1949 but never billed to the Agency because of both the cost ceiling and expiration date. To some extent, these costs might constitute firm obligations incurred prior to 1 February 1949 which were not recorded until on or after that date.

From his review of the contract, the writer is unable to determine whether reimbursement could be allowed in this regard. On the one hand the Contractor was not obliged to complete the work at its own expense because of the "Cost Escape" clause of the contract. Article 3. provides that such sum of money as the Government may determine to be fair and proper for such property shall be "returned" to the Government, implying perhaps that such return is to be accomplished after termination of the work and final determination of the reimbursement therefor. If the latter hypothesis is correct, then no recovery by the Contractor could arise out of its return to the Agency of the fair price of such property as it is permitted to purchase. Thus, if recovery for costs otherwise unrecoverable were permitted in this manner, the effect would be to enable the Contractor to acquire same, at least, of the property at no cost to itself.

On the other hand, the Contractor has not taken advantage of its contractual rights to bill an allowance for overhead equal to 100% of Direct Labor before taxes, nor to proceed no further toward completion of the work when the cost limitation of \$125,000.00 was attained. The Contracting Officer, therefore, if permitted to consider the question at all may wish to temper his views with these considerations.

In any event, in the writer's opinion the recovery if allowable would be limited solely to materials and services for which the Contractor obligated itself on purchase orders placed on or before February 1949 and would not extend to labor or overhead costs incurred after 1 February 1949.

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6. RECOMMENDATIONS - In conclusion, the writer submits the following recommendations arising out of this audit:

(1) That, subject to the Contractor's submission of a bill in the indicated amount for unbilled January 1949 costs, the sum of \$124,851.65 be proposed in settlement of this contract.

(2) That the Office of the General Counsel determine whether the acceptance of the Contractor's proposals for purchase of property acquired under the contract would permit the Contractor to recover otherwise allowable costs which cannot now be allowed because of the cost ceiling.

(3) That the Contracting Officer give consideration to establishing as a regular practice the direction of interim audits prior to completion of the contract work on those contracts covering an extensive period of time and sufficiently material in amount to justify the extra audit expense. Thereby, would be achieved, in the writers opinion, (1) an earlier determination of the acceptability of the Contractor's accounting system and practices with possible savings and early positive assurances resulting therefrom, and (2) the readier reconciliation and settlement of disputes regarding questions of cost determination which would result in the review of transactions of current rather than principally past periods.

Respectfully submitted,

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**CONTRACT COST ANALYSIS CONSTITUTING
A DECOMMENDED CONTRACT SETTLEMENT
Period 2 June 1947 Through 31 January 1949**

	<u>Billed Through 31 January 1949</u>	<u>January 1949 Not Billed</u>	<u>Total</u>
Salaries and Wages			
Contractor element	\$49,423.78	\$ 71,376.06	\$ 71,376.06
[REDACTED] element	<u>21,952.28</u>	<u>17,300.15</u>	<u>18,677.69</u>
Materials and Services			
Overhead	25,849.33	96.13	25,945.46
Communications	134.00		134.00
Travel	<u>555.48</u>	<u>(4.90)</u>	<u>550.58</u>
Total Contract Costs	<u>\$115,215.02</u>	<u>\$1,468.77</u>	<u>\$116,683.79</u>
Fixed Fee	<u>8,021.04</u>	<u>146.82</u>	<u>8,167.86</u>
Total Cost To Government	<u>\$123,236.06</u>	<u>\$1,615.59</u>	<u>\$124,851.65</u>

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